SBA

C86

Business Basics

Credit and Collections: Policy and Procedures

A Self-Instructional Booklet
1014

NEWARK PUBL'C LIBEARY
OCT 2 1980
U. S. GOVT. PUBS.
DEPOSITORY 375

U.S. Small Business Administration
Office of Management Assistance

SBA 1.19:

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402
S/N 845-000-00180-6 $2.50

KEEP THIS GUIDE SHEET -- FOR INSTRUCTOR'S USE ONLY

CREDIT AND COLLECTIONS: POLICY AND PROCEDURES
Instructor's Guide Sheet

This booklet contains:

1. Credit in Today's Economy
2. Credit Extensions
3. Accounts Receivable Analysis for Credit Problems
4. Aging Receivables
5. Reduce Credit and Collection Problems
6. Terms of Sale
7. Past Due Follow-up
8. Outside Collection Aids
9. Bank and National Credit Card Services

Supplementary Instruction:

Assist the Client:

1. Determine average collection period and compare the client's experience with the industry average.

2. Prepare an aging of receivables to identify specific problems and to show the client how to maintain an aging on a continuing basis.

3. Review check lists in the module to develop applicable policies and procedures that will minimize the risk of credit losses.

4. Review invoicing practices, terms of sales offered to customers, credit approval policies and procedures, preparation of statements, and follow-up activities with past-due accounts.

5. Prepare a series of letters to past-due accounts that reflect the client's own personality and writing style, but retain the basic techniques of a progressively firmer tone.

6. Contact local resources for bank and national credit cards so that the terms and conditions can be reviewed to determine if such services meet the client's needs.

NOTE: Prior to taking this booklet, the participant should have completed the introductory booklet in this series, Asset Management.

blank page

INTRODUCTION

"Plastic" has become a way of life. Those wallet-size credit cards are accepted all over the world in millions of stores for many millions of products and services. To be competitive, you too must offer credit to your customers. After all, your own business purchases are probably on credit.

Management of Receivables

As the operator of a small business, you must extend credit to customers on competitive terms so that sales will not be lost. At the same time, you must avoid long overdue accounts so that your capital will not be tied up and there will be less chance of accounts becoming uncollectible. If you manage your accounts receivable as suggested in this module, you will realize the marketing advantages of credit extensions and avoid the common problems noted above.

Booklet Objectives

This booklet has been designed to guide you in the management of your accounts receivable. In this booklet, you will learn how to establish sound policies that will serve as guidelines in granting credit. You will be shown collection techniques that will minimize uncollectible accounts and reduce the volume of past-due accounts so that your credit sales are more quickly converted to cash. You will learn how to analyze your accounts receivable to determine whether or not a problem exists, if corrective action is needed, or if reevaluation of your credit and collection policies is necessary. You will learn how to evaluate credit applications so that many problems can be eliminated before they occur. You will learn how to initiate a collection program with all accounts, the delinquent and the not yet delinquent. You will learn how to follow up by mail and telephone to accelerate collections and the flow of cash to your business. You will learn when to resort to external resources such as collection agencies or the courts and how to use them to your advantage.

Benefits

If you apply the techniques you learn in this booklet to the management of your business, your dollars tied up in accounts receivable should be reduced, allowing for profitable application elsewhere. In addition, your credit losses should be reduced.

CREDIT EXTENSIONS

Judgment

Many potential credit problems can be eliminated before they happen through investigation and prudent judgment when granting credit to customers. The need for sound judgment is particularly critical since credit extension policies should be neither too liberal nor too restrictive. Overly liberal policies invite excessive receivables and uncollectible accounts while overly restrictive policies cause lost sales.

Investigation

Before you decide, get the facts. Thorough investigation of credit requests protects you from the fraudulent applicant who has no intention of paying as well as the applicant who is extremely slow in paying.

Credit Applications

The basic source of information for decisions on credit extensions is the credit application. A typical credit application appears as Exhibit 1 at the back of the book. This credit application, which would apply to an individual, should be completed in detail and the information verified.

Evaluation Factors

There are three major factors to consider in evaluating a credit applicant. The first is the applicant's ability to pay, based upon income and obligations. The second is willingness to pay, which can be determined from the applicant's credit history. The third factor is potential profitability of the account. You stand to lose your cost of the product or service sold to the customer if you cannot collect an account. If your cost is relatively high compared to the selling price, then you have to be particularly careful in assessing credit risks.

Application Evaluation

Your evaluation of any credit application will depend upon a number of factors. In the case of an individual applicant, you will want to consider the following:

- Employment history
- Current position
- Current income
- Time on job
- Job security
- Monthly obligations (rent, loan payments, food, utilities, etc.)
- Bank balances
- Personal assets (house, cars, stocks, bonds, etc.)
- Credit standing
- Amount of credit desired

Information Verification

Information on credit applications must be verified to ensure that it is correct, current, and complete. A good place to begin is the place of employment to verify that the applicant is employed and that income and time on the job have been reported accurately.

Bank references should also be verified. While state and federal laws restrict the amount of information that banks can disclose, checking on this information can protect you from obvious fraud and may give you some indication of the applicant's ability to pay. Most banks will confirm the existence of an account and disclose a broad idea of the average balance. The bank may also indicate whether or not the account has been satisfactory.

Credit Bureaus

An important source of information for retail credit is the local credit bureau, which generally provides information on credit applicants to firms that are bureau members. Annual membership fees usually depend upon the size of the business.

Besides the membership fee, there is a nominal charge for each inquiry on a credit applicant. Your local credit bureau will provide you with details about services and costs.

Stability

In situations where the time or cost of a comprehensive credit check is prohibitive, professional credit managers have often found that a quick evaluation can be made based upon the applicant's stability. Stability is determined by the length of continuous employment and residence. This assumes that the person who has been employed for several years on the same job will most likely continue to be employed and therefore will be able to pay. Similarly, continuous residence indicates a desire to maintain standing in the community.

Summary

There are no hard and fast rules that can tell you who is a good credit risk and who is not. There are cases where the poorest of people pay their bills promptly, while the wealthy ignore them. As the owner of a small business, you must combine facts about the applicant with common sense to determine those risks that appear reasonable.

NOTE: Cover the correct answers and write your answers on a separate piece of paper (or in the book). Check your answers and review weak areas. Do all the exercises the same way.

Examine the credit application, Exhibit 1, at the back of this book. Assume that Mary Wallace received a favorable report from the local credit bureau. To answer whether or not you would grant $500 credit, answer the following questions:

1. How would you describe her employment history? (FAVORABLE/UNFAVORABLE)

FAVORABLE

---

2. Does her monthly income appear sufficient to cover her fixed living obligations? (YES/NO)

YES (Her combined monthly income is about $1,300. Her rent of $250, with no car payments and a small loan payment, should leave ample income for food, clothing, utilities, and other necessities.)

---

3. With whom would you check to verify the information on the application?

1.
2.
3.

County Supreme Court
First County Bank
County Realtors, Inc.

---

4. Would you approve her credit application? (YES/NO)

YES (most likely)

---

5. Information on an applicant's credit history is available from local _____ bureaus.

---

credit

---

6. The two most important factors about an applicant that must be considered in your evaluation are _____ to pay and _____ to pay.

---

ability, willingness

---

7. An applicant's income and obligations determine _____ to pay.

---

ability

---

8. An applicant's credit history reveals information about _____ to pay.

---

willingness

---

9. When the profitability of your product or service is relatively high, you would probably be (MORE/LESS) liberal in extending credit.

MORE

---

10. When the cost of time required for a thorough investigation of a credit applicant is prohibitive, you can get a quick idea of the applicant's credit worthiness by checking out the applicant's _____ .

---

stability

---

* * * * *

Commercial Credit

Commercial accounts should complete an application similar to that used for personal credit. Unlike individual credit applications, it is often difficult to verify information on income and expenses for businesses. It is also more difficult to make estimates of these factors for commercial accounts. There are situations where it may be reasonable to request a financial statement from the commercial account before extending credit, but these situations are not typical. Instead, you must rely more heavily upon references such as banks and suppliers with whom the applicant does business, the applicant's reputation in the industry, identity of officers, and so on.

The application should note the names of individuals who are authorized to purchase for the account so that fraudulent purchases can be detected. There should also be an indication of purchase order requirements so that you will be protected in the event of an unauthorized purchase. (A typical commercial credit application appears as Exhibit 2 at the back of the book.)

Frequently, the commercial applicant with a marginal credit rating will list only those suppliers with whom a satisfactory relationship has been maintained. However, you can often use your own judgment and knowledge of your industry and locale to determine other suppliers with whom the applicant may have done business. If there is any doubt in your mind as to the credit worthiness of the applicant, it is always a good idea to contact these other sources to find out what their experience has been.

Commercial Credit Services

Commercial credit services maintain financial information and credit services for large and small companies throughout the country. The cost of this service varies with the detail and depth of information requested on any applicant.

325-849 O - 80 - 2

PROBLEM DETECTION

A successful credit and collection policy requires that all problems be detected and acted on as early as possible. The sooner a problem is detected, the sooner it can be corrected. This is particularly critical in receivables management where the sheer passage of time can aggravate any problem that may exist.

An important indicator of the effectiveness of your credit and collection policy is your average collection period. The average collection period is a ratio that expresses the total amount of receivables outstanding in terms of an equivalent number of average daily credit sales.

Figuring the Average Collection Period

The average collection period is calculated as follows:

Accounts Receivable ÷ Average Daily Credit Sales

Or, viewed another way, the total amount owed by customers is equivalent to 45 days' credit sales, on the average.

For example, if a business had average monthly credit sales of $6,000 and outstanding accounts receivable of $9,000, the collection period would be calculated as follows:

Average Daily Credit Sales = Average Monthly Credit Sales ÷ 30

Average Daily Credit Sales = $6,000 ÷ 30

Average Daily Credit Sales = $200

Average Collection Period = Accounts Receivable ÷ Average Daily Credit Sales

Average Collection Period = $9,000 ÷ $200

Average Collection Period = 45 days

This indicates that, on the average, customers are taking 45 days to pay their accounts. (Some formulas for calculating the average collection period consider only net credit sales. These are determined by subtracting an estimated allowance for bad debts from total annual credit sales. While the result is mathematically more precise, it is being ignored here and the simpler formula, based upon total credit sales, is being used for instructional purposes.)

Comparisons

The average collection period can be compared with any of the following bases to determine whether or not a problem exists.

- Payment terms. If your terms of sale specify payment within 30 days and your average collection period is greater than this, it indicates that creditors are not complying with your terms and a problem exists.

- Past history. Comparison with your experience in previous periods indicates whether or not collections are improving or declining.

- Industry averages. Comparison with the experience of other companies in your industry will determine whether or not your credit and collection policies are as effective as those of your competitors. (Industry averages are usually available at your library or trade association.)

Determining the Extent of the Problem

The extent of the receivables' excess can be measured by comparing your actual receivables with a target level. For example, assume that your terms of sale specify payment within 30 days, and your industry average collection period is approximately 30 days. A suitable target for your receivables would then be 30 days' average credit sales. If your average daily credit sales are $200, you could then calculate a target for receivables as follows:

Average Daily Sales x Collection Period = Receivables

$200 x 30 = $6,000

If your actual receivables were $9,000, you would then know that you had an average of $3,000 ($9,000 - $6,000) in receivables that require attention.

Corrective Action

A relatively high average collection period indicates that a problem exists and corrective action must be taken. Prompt attention should reduce the collection period, speed conversion of receivables to cash, minimize your capital tied up in accounts receivable and, at the same time, reduce the risk of uncollectible accounts.

* * * * *

1. The ratio that expresses the balance of accounts receivable in terms of an equivalent number of average daily sales is called the _____ _____.

---

collection period

---

2. To calculate the average collection period, you would:

   a. divide accounts receivable by average daily sales
   b. divide average daily sales by accounts receivable

---

a. divide accounts receivable by average daily sales

---

3. A business has average monthly sales of $60,000. Average daily sales are $ _____.

$2,000 ($60,000 ÷ 30)

---

4. With average daily sales of $2,000 and accounts receivable of $50,000, the collection period would be _____ days.

---

25 days ($50,000 ÷ $2,000)

---

5. If a business has both cash and credit sales, you would consider only _____ sales when determining the average collection period.

---

credit

---

6. List three bases of comparison that can be used to determine whether or not the average collection period for your business is high.

   1.
   2.
   3.

---

   payment terms
   past history
   industry averages

---

7. If your terms of sale specify payment within 30 days and your average daily credit sales are $500, your accounts receivable probably should not exceed $ _____.

   $15,000 ($500 x 30)

---

8. If, in the preceding example, your actual accounts receivable were $20,000, your excess would be $_____ .

   $5,000 ($20,000 - $15,000)

---

9. If your average collection period is higher than your industry average, it probably indicates that:

   a. your credit and collection policies are ineffective
   b. your credit and collection policies are effective

---

   a. your credit and collection policies are ineffective

---

* * * * *

Aging of Receivables

Analysis of your average collection period will help you identify and measure receivables problems in total. However, immediate corrective action requires identification of individual problem accounts.

Problems in individual accounts can be detected through analysis of your receivables by aging. A receivables aging divides each customer's account into amounts that are 0-30 days old, 31-60 days old, 61-90 days old, etc.

The longer an account is past due, the more serious the problem. These can be identified quickly by aging, and corrective action can be initiated promptly.

For example, examine the receivables aging below. The first account shown, L. Brown, has a total outstanding of $775.02. Of this amount, $317.91 is 0-30 days old, $222.63 is 31-60 days old, $156.32 is 61-90 days old, and $78.16 is over 90 days old. Some prompt action seems required.

ACCOUNTS RECEIVABLE

MARCH 31, 197X

	TOTAL	0-30 DAYS	31-60 DAYS	61-90 DAYS	OVER 90 DAYS
L. Brown	$ 775.02	$ 317.91	$222.63	$ 156.32	$ 78.16
A. Charles	426.58	426.58			
B. Doherty	507.19				507.19
F. Eagle	1,871.67	736.12	617.02	518.53	
R. Francis	896.15	896.15			
L. Gillis	1,343.41			716.48	626.93
M. Holloway	271.42	271.42			
TOTAL	$6,091.44	$2,648.18	$839.65	$1,391.33	$1,212.28
	100.0%	43.5%	13.8%	22.8%	19.9%

Totals are entered for each age group. It is often useful to calculate the percentage of total receivables in each age group to alert you whenever overdue receivables become excessive. For example, if you knew from past experience, or from industry averages, that receivables more than 90 days past due were seldom more than 5% of total receivables, the 19.9% would instantly alert you to a dangerous situation that requires immediate correction before you are faced with possible serious losses.

* * * * *

1. Refer to the accounts receivable aging on the previous page. Which accounts are current (0-30 days old)?

A. Charles
R. Francis
M. Holloway

---

2. What percentage of total receivables are past due (more than 30 days old)? _____%

56.5% (13.8% + 22.8% + 19.9%)

---

3. What action should be taken with L. Brown? Explain.

Probably should be C.O.D. Despite old balance, continues to buy.

---

4. How would you interpret the account of L. Gillis?

The business has probably lost an important customer because of failure to pay.

---

* * * * *

INTERNAL COLLECTION PROCEDURES

Minimum Time Period

The fundamental rule of sound receivables management is to minimize the time span between the sale and collection. Any delays that lengthen this span cause receivables to build to unnecessarily high levels and increase the risk of uncollectible accounts. This is just as true for delays caused by your billing and collection procedures as it is for delays caused by the customer.

Invoices

Proper collection procedures begin with invoice preparation. Invoices should be prepared promptly and accurately. Promptness eliminates one possible source of delay. Accuracy prevents those delays that occur when the customer disputes the invoice and returns it for correction, triggering a chain of events that is time-consuming and often costly.

Invoices should clearly state payment terms. Is payment due within 10 days? Thirty days? Are the days measured from the receipt of goods? Receipt of invoice? End of the month?

Cash Discounts

When selling to large accounts such as commercial, industrial, institutional, and governmental buyers, collection is often accelerated by the offer of a cash discount. The discount, usually 1% or 2%, is offered for payment within 10 days. Most large organizations take advantage of all such discounts. In so doing, they can sharply reduce your commitment of capital to accounts receivable. If your competitor offers cash discounts, it may be necessary for you to include the same provision to maintain your competitive position.

Specifying Payment Terms

Payment terms normally include <u>discount terms</u> and <u>dating terms</u>. Discount terms describe the discount available, if any, for prompt payment. Dating terms specify the time when payment is due.

Discount terms are usually described as follows:

2/10

The number before the / is the discount percentage, in this case 2%. The number following the / is the number of days within which payment must be made in order to take advantage of the discount. In the example, the customer can take a 2% discount for payment within 10 days.

This leads to the next question, 10 days from when? And, if the customer lets the discount period pass, when is the net amount due? The answers to these questions are specified in the dating terms. Extending our previous example a little further, the terms might be expressed as follows:

2/10 - n30

The "n" is an abbreviation for net. The "30" indicates that payment is due within 30 days. If no other date is specified, the 30-day period begins with the invoice date. For example, if the terms above appeared on an invoice dated September 2, the customer would be entitled to a 2% cash discount for payment by September 12. If the customer does not pay within this period, the net amount is due within 30 days, or by October 2.

Special Conditions

Large accounts often specify certain requirements for invoice preparation. They may require reference to a purchase order, proof of delivery, or a certain number of copies. Be certain that these conditions are met when the invoice is first prepared and submitted in order to avoid delays and duplication of effort.

Statements

To keep customers advised of their account balances, monthly statements should be submitted to all open accounts. The statement should summarize the amount owed and any activity in the account within the month.

Abbreviations are used to specify the beginning of dating periods that are different from the invoice date. Two common abbreviations are "EOM," End of Month, and "ROG," Receipt of Goods. In the first case, EOM, the discount and net periods begin at the end of the month, regardless of the invoice date. In the second case, ROG, the periods begin when the customer receives the goods, regardless of the invoice date.

Assume that an invoice issued on September 15 had the following terms:

325-849 O - 80 - 3

2/10 - n30 EOM

The customer would be entitled to a 2% discount for payment by October 10. If the discount is forfeited, the net amount would be due October 30.

Your choice of payment terms will often depend upon customary practices in your business. In order to stay competitive, it is often necessary to offer payment terms that are equivalent to those offered by your competitors.

Delinquency Charge

In some businesses, a delinquency charge for late payment is used to discourage customers from allowing their accounts to become long past due. The delinquency charge normally involves a finance charge or service charge of 1% to 1½% per month on all balances more than 30 days past due. For example, if a customer's statement at the end of June indicates a total balance due of $630, of which $417 is more than 30 days past due, the finance charge for June would be calculated as follows (assuming a 1% delinquency charge).

$417 x .01 = $4.17

Most people recognize that a charge of 1% per month represents an annual interest expense of 12% (12 x .01). A charge of 1½% per month represents an annual interest charge of 18% (12 x .015).

Follow-up

The best time to initiate pursuit of outstanding balances is immediately. As an account gets further behind, the balance often increases, while the chances of collection decrease. The person who owes a few hundred dollars today is not likely to be in better shape to pay next week or the week after than right now. Now is the time to start enforcing a rigid collection policy, making whatever arrangements are necessary to be sure that you receive the money due to you in a reasonable period of time.

Don't Be Reluctant

Many businesses are reluctant to enforce strict collection procedures. The reasons for this are several, and none of them are valid. Some people simply are embarrassed to ask for money even though it is owed to them. Others express concern that they might alienate a "good customer" and

perhaps lose an account. The opposite is true. How good is an account if the bills are not paid? Even more important, the customer owing you a large balance may be reluctant to do more business with you until the account is cleared. You have not only lost your money, you have also lost a customer.

Some companies feel that rigorous enforcement of a collection policy can damage their reputation. Viewed logically, would you conclude that a person who owes you money is likely to spread this news around town?

* * * * *

1. Proper collection procedures begin with:

    a. invoice preparation
    b. monthly statement submission
    c. referral to a collection agency

---

    a. invoice preparation

---

2. A discount offered for prompt payment is called a _____ discount.

---

    cash

---

3. Cash discounts are usually:

    a. 1 or 2%
    b. 5 or 10%
    c. 15 or 20%

---

    a. 1 or 2%

---

4. Cash discounts are usually offered to (COMMERCIAL/ PERSONAL) accounts.

COMMERCIAL

---

5. Cash discounts are usually offered for payment within _____ days.

10

---

6. Terms of payment consist of discount terms and _____ terms.

---

dating

---

7. The terms, 2/10 - n30, indicate that a cash discount of _____% is available for payment within _____ days.

2%
10

---

8. In the preceding example, the net amount is due within _____ days if the discount is forfeited.

30

---

9. If no other beginning date is specified, the discount and net payment periods ordinarily begin:

   a. on the invoice date
   b. at the end of the month
   c. the day the goods are received

---

   a. on the invoice date

---

10. The abbreviation, EOM, means _____.

---

   end of month

---

11. The abbreviation, ROG, means _____.

---

   receipt of goods

---

12. An invoice dated June 17 has the following terms:

   2/10 - n30 EOM

   The discount is available for payment by _____.
   The net amount is due by _____.

   July 10
   July 30

---

13. A delinquency charge of 1% per month on amounts 30 days past due represents an annual interest charge of _____%.

   12% (12 x .01)

---

14. Are there any valid business reasons for failing to pursue a vigorous collection policy? (YES/NO)

NO (If your answer is YES, please explain.)

---

* * * * *

Past Due Accounts

Whether or not your business chooses to use cash discounts or delinquency charges, a systematic follow-up procedure should be employed with all past-due accounts. Usually, this will take the form of a series of letters or telephone calls or both, as required.

First Collection Letter

When an account becomes approximately 15 days past due, the customer should be sent the first collection letter. Since the account cannot be considered seriously delinquent at this time, the tone of the letter should be moderate. Later letters should establish a firmer tone so that the customer is made aware of the seriousness of the situation.

The 15-day past-due letter should read about as follows:

> Dear Mr. Adams:
>
> According to our records, your current balance due is $473.25. Of this amount, $215.38 is more than 30 days past due. As you know, our normal terms require payment within 30 days after the invoice is sent to you.
>
> Since you have established an excellent credit rating with us in the past, we are surprised to see a problem arise at this time. If there is some error, or you are unable to pay the amount due immediately, please contact me so that we can correct the situation or make suitable arrangements for prompt payment of this obligation.
>
> Thank you for your attention to this request.
>
> Very truly yours,
>
> Jim Madison
>
> Jim Madison

Second Collection Letter

A second letter, 30 days later, might read as follows, if no response has been received from the customer:

Dear Mr. Adams:

We have not received any response from our statements of the last two months nor to our letter of September 15. Your entire account is now 45 days overdue, and you owe us a total of $473.25.

If there is some reason why this payment cannot be made immediately, please contact us so that we can make arrangements that will be mutually agreeable. Perhaps we can work out a payment schedule that would be realistic for your present circumstances.

Naturally, we do not want to endanger your credit rating or destroy the good relationship that we have maintained in the past. Therefore, would you please take care of this obligation immediately so that we will not have to file an unfavorable report with the credit bureau or resort to the use of a collection agency or an attorney.

We have enclosed a self-addressed envelope for your convenience. Please return it as soon as possible with your check for the balance owed.

Very truly yours,

Jim Madison

Jim Madison

Third Collection Letter

If this is unsuccessful, a stronger letter should be sent in 30 days:

Dear Mr. Adams:

We still have no response from our statements of the past three months nor from the letters that we sent you on September 15 and October 15.

Your entire account is now seriously past due! It is obvious that our efforts to clear the account on a mutually agreeable basis have had no impact. Unless we receive payment from you within seven days, or can work out a mutually agreeable arrangement to discharge this obligation, we will have to report the matter to the retail credit bureau.

Subsequently, the account will be turned over to a collection agency or to our attorneys for further action. Since this is a costly procedure for both of us, and will cause serious damage to your credit rating, I would suggest that you call immediately so that we can clear the matter at once without resorting to such procedures.

Very truly yours,

Jim Madison

Jim Madison

As you noticed, the tone of each letter became progressively stronger with suggestions of more serious action introduced in each case. The tone that you would want to establish in such "dunning letters" will often depend upon the type of relationship that you maintain with your customers. However, the ground rules should be clear. Past-due accounts should not be ignored.

Telephone

Frequently, an even more persuasive approach is through use of the telephone. The ground rules are basically the same. You must become progressively firmer with each call and indicate that stronger measures will be used if necessary to ensure prompt payment.

The telephone has the added advantage of flexibility since you can be more direct with better knowledge of the individual account.

You acquire this knowledge through asking questions such as the following:

. "What seems to be the problem? We never had difficulty with your account in the past."

. "How much would be a reasonable amount for you to pay each month? Perhaps $50, $60?"

. "How soon can we expect payment of this amount?"

Try to avoid questions that can be answered "yes" or "no." If the creditor gives you an answer such as, "I'll mail it today," answer with: "I appreciate that. Then I can expect it in two or three days. If I don't have it by then, I'll call you back."

Be sure that the creditor realizes that you are totally aware of the situation and that you do not intend to ignore it.

* * * * *

1. Successive collection letters should become progressively (STRONGER/MILDER).

STRONGER

---

2. The first collection letter should acknowledge the possibility of some error, oversight, or misunderstanding. Should the second or third? (YES/NO)

NO

---

3. Name three possible actions that can be suggested to the customer in order to prompt payment:

   1.
   2.
   3.

---

unfavorable credit report
collection agency
attorney

---

4. Would the style and tone of the letters described in the text be suitable for all businesses? (YES/NO) Please explain your answer.

NO. They would be perfectly suitable for any business where there is no strong personal relationship between the business and the customer. In many cases, personality factors would have to be considered.

---

5. Why is the telephone often a more persuasive tool?

It permits you to get more information through the careful use of questions.

---

6. Which of the following is the better question?

a. "Do you intend to pay?"
b. "When do you intend to pay?"

---

b. "When do you intend to pay?"

(Since it cannot be dismissed with a casual "yes," it forces a commitment.)

---

* * * * *

EXTERNAL COLLECTION RESOURCES

Available Alternatives

If your own collection efforts fail, there are two courses of action that are left to you -- the collection agencies and the courts.

Collection Agencies

Collection agencies are businesses established to collect past-due accounts receivable on behalf of creditors. The primary advantage that collection agencies offer is their superior knowledge of persuasive collection techniques. Additionally, creditors are usually anxious to clear invoices referred to collection agencies rather than further damage their credit ratings.

The collection agency's fee is usually based upon a percentage of each account collected. The percentage ranges from 25% to 50% depending upon the size of the account or the total dollar volume of accounts referred to the agency for collection. This approach, while often effective, can be expensive.

A business is committed to paying the agency's fee on any account referred for collection, whether payment is made to the agency or to the business. Although some creditors may resent making payment to a collection agency and prefer to pay the company directly, the company is still committed to pay the fee when the account is collected.

Courts

If the collection agency fails, your final recourse is through the courts. The matter may be resolved in a small claims court if the amount owed is small. For larger amounts, you may have to file suit to collect. In either case, you are faced with a costly and time-consuming procedure.

The best way of avoiding these time-consuming, costly procedures is to take prompt, strong action on your own as early as possible. In the long run, you will be doing not only yourself a favor but also the creditor. While your creditors may be unhappy at the time, you will have spared them costs, time, and the loss of their credit ratings.

* * * * *

1. What two collection resources are available to you if your own efforts fail?

   1.
   2.

---

   collection agencies
   courts

---

2. What is the primary advantage of collection agencies?

---

   superior collection techniques

---

3. What is a likely range of fees for a collection agency?

   a. 5% to 10% of amounts collected
   b. 10% to 25% of amounts collected
   c. 25% to 50% of amounts collected

---

   c. 25% to 50% of amounts collected

---

4. Identify two significant cost elements involved in court proceedings to collect outstanding accounts.

   1.
   2.

---

   legal fees
   loss of time from business

---

5. Which of the following is the most economical method of collecting accounts receivable?

   a. firm collection policy
   b. referral to collection agencies
   c. referral to the courts

---

   a. firm collection policy

---

* * * * *

BANK AND NATIONAL CREDIT CARDS

Many problems associated with credit can be avoided through the use of bank and national credit cards. In many businesses, particularly in the retail and consumer service fields, credit arrangements for customers are available through the use of these cards. Under these plans, there is little or no commitment of the business' own capital, and the costs and risks of administration and collection are almost entirely the responsibility of the credit card company or bank.

Credit card service is available from your regular commercial bank. Receipts from bank credit card purchases can be deposited daily and are immediately credited to your checking account. The bank assumes all credit risks provided that you follow instructions for approval of credit card purchases. Typically, these instructions require that you check the validity of the card against a master list of canceled cards and contact the credit service before accepting the customer's card for purchase above a certain limit.

In return for this service, the bank charges a percentage of total credit card sales.

The national credit services operate on a similar basis, but do not offer the advantage of daily credits to the business' checking account. As with bank credit cards, the business must follow established procedures and, by so doing, eliminates any risk associated with uncollectible accounts. Normally, national credit card companies remit to the business twice monthly and charge a fee based upon a percentage of total credit card sales.

Credit card services are particularly vital for businesses with a large number of relatively small accounts. They eliminate the need for credit approval, invoice preparation, record maintenance, and collections. They also minimize your commitment of capital and virtually eliminate the risk of uncollectible accounts. From a marketing standpoint, the availability of instant credit could often encourage a customer to buy immediately, rather than postpone the decision to a later date or bypass it completely.

Credit cards are most often used for retail accounts. However, they have also been used successfully in selling to small commercial accounts. Businesses such as repair shops, supply firms, and stationery stores, which have a mixture of consumer and commercial accounts, often find it convenient and economical to extend credit card service to small commercial accounts.

* * * * *

1. List two advantages of the use of national and bank credit card services:

   1.
   2.

Less commitment of the business' own capital.
Reduced risk of bad debts.

---

2. Under what conditions could a business be liable for losses on bank and national credit cards?

If it failed to follow established authorization procedures.

---

3. Which of the following businesses would probably find the use of credit card services most appropriate?

   a. a business with a large number of small accounts
   b. a business with a small number of large accounts

---

a. a business with a large number of small accounts

---

4. With bank credit card services, the business can effectively receive cash from credit sales on a (DAILY/MONTHLY) basis.

DAILY

---

* * * * *

CREDIT AND COLLECTION POLICIES

The establishment and execution of credit and collection policies can minimize problems associated with accounts receivable. As with all policies, they must be reevaluated from time to time in order to determine their effectiveness. If your business already has policies for receivables management, evaluate them according to the check list on the following pages. If you do not presently have credit and collection policies, you can use the check list as a guide in establishing policies.

Your answer to all questions should be "Yes" or "Not Applicable." If you have any "No" answers, you should consider revising your policy or have a strong and valid reason for not doing so. For example, you may have a "No" answer to the question, "Do you offer a cash discount?" If your accounts are primarily personal, this might be a valid answer. If your accounts are primarily major industries, a "No" answer would suggest that you consider the possibility of offering a cash discount.

CREDIT AND COLLECTION POLICIES CHECK LIST

	Yes	No	Not Applicable
Credit Approval			
Is a written application required with every credit request?	___	___	___
Do you have a standard form for credit applications?	___	___	___
Is it completed personally by the applicant?	___	___	___
Is it reviewed for completeness?	___	___	___
Is all information verified for accuracy and timeliness?	___	___	___
Are applicants checked out with a credit bureau?	___	___	___
Does your evaluation consider income?	___	___	___
Does your evaluation consider fixed obligations?	___	___	___
Does your evaluation consider job stability?	___	___	___
Does your evaluation consider residential stability?	___	___	___
Does your evaluation consider credit history?	___	___	___
Does your evaluation consider bank balances?	___	___	___
Does your evaluation consider other assets?	___	___	___
Invoices			
Are invoices prepared promptly?	___	___	___
Is invoice preparation always accurate?	___	___	___

	Yes	No	Not Applicable
Are payment terms clearly stated?	___	___	___
Are customers' special instructions followed carefully?	___	___	___
Terms of Sale			
Do you offer a cash discount?	___	___	___
Do you use a late payment penalty?	___	___	___
Is the time limit for payment clearly stated?	___	___	___
Statements			
Are monthly statements submitted to all open accounts?	___	___	___
Are statements prompt and accurate?	___	___	___
Problems of Identification			
Do you determine your average collection period on a regular basis?	___	___	___
Do you compare your collection period with industry averages?	___	___	___
Do you compare your current collection period with your previous experience?	___	___	___
Do you compare your collection period with your payment terms?	___	___	___
Do you have a monthly aging of all outstanding accounts?	___	___	___
When a problem is identified, is corrective action prompt and firm?	___	___	___

	Yes	No	Not Applicable
Follow-up			
Do you have a systematic procedure for follow-up on slow accounts?	___	___	___
Is there a standard sequence of follow-up letters?	___	___	___
Is the tone of these letters progressively stronger?	___	___	___
Do you use the telephone to contact delinquent accounts?	___	___	___
Is your telephone technique effective?	___	___	___
Do you offer special arrangements for collecting past-due accounts?	___	___	___
Do you have a late-payment penalty?	___	___	___
Do you put delinquent accounts on a C.O.D. basis?	___	___	___
External Resources			
Do you have a working relationship with a collection agency?	___	___	___
Are accounts turned over automatically after a specific time period?	___	___	___
Do you refer the most serious delinquencies to an attorney?	___	___	___

SUMMARY

Sound policies for credit and collection can eliminate many problems before they occur and minimize those that do occur. In this module, you have learned the techniques of receivables management. If you apply these techniques to your own business, your profit will improve and your cash position will be strengthened. Profit will improve through fewer credit losses and lower costs of credit administration. Capital will be freed so that you will be able to meet your own obligations promptly and invest in those assets that offer a significant profit potential.

U.S. GOVERNMENT PRINTING OFFICE : 1980 O - 325-849

blank page

EXHIBIT 1

CREDIT APPLICATION

NO. 1754	$500 LIMIT		DATE 12/15/7X
FULL NAME MARY WALLACE			AGE 38
ADDRESS 15 WEST PLACE, CONCORD, N.J. ZIP 07647			HOW LONG 10 YRS.
HOME PHONE 607-5421	BUSINESS PHONE 613-4700	☐ SINGLE ☐ MARRIED ☒ DIVORCED	NUMBER OF DEPENDENTS (INCLUDING SPOUSE) 4
FORMER ADDRESS 36 MAIN ST., CONCORD	ZIP		HOW LONG
EMPLOYED BY COUNTY SUPERIOR COURT		ADDRESS 100 PARK PLAZA, CONCORD ZIP 07647	
HOW LONG 7 YEARS	POSITION ASS'T. CLERK	MONTHLY INCOME $ 1,000	OTHER INCOME $ 300 (CHILD SUPPORT)
PREVIOUS EMPLOYER NONE		ADDRESS ZIP	HOW LONG
BANK ACCOUNT FIRST COUNTY BANK		BRANCH DOWNTOWN	CHECKING ☒ SAVINGS ☒
NAME OF SPOUSE —	EMPLOYED YES ☐ NO ☐ —	WHERE EMPLOYED —	MONTHLY INCOME $ —
DO YOU OWN AN AUTOMOBILE YES ☒ NO ☐		WHEN PURCHASED 5 YEARS AGO	FROM WHOM KING FORD
NEAREST RELATIVE WITH WHOM YOU ARE NOT LIVING:			
NAME SALLY THOMAS	ADDRESS 56 BLAKE RD., LEXINGTON, MA ZIP		RELATIONSHIP MOTHER
REAL ESTATE OWNED (OTHER THAN HOME) NONE			

CREDIT REFERENCE

TYPE	IN ACCOUNT WITH	ADDRESS	MONTHLY PAYMENT	BALANCE OWING
HOME ☐ OWN ☒ RENT	COUNTY REALTORS	5000 GREELY DR. CONCORD	$ 250	$
AUTOMOBILE ☒ OWN ☐ LEASE			$	$
OTHER			$	$
OTHER			$	$
CREDIT CARD	BAMBERGERS	CARD NO. 176542	$ 20	$ 150
CREDIT CARD		CARD NO.	$	$
ALL OTHER INSTALLMENT OBLIGATIONS (IN TOTAL) NONE			$	$

IF GRANTED CREDIT I AGREE TO PAY ALL BILLS PER THE FOLLOWING TERMS:

NET 30 DAYS

SIGNED: Mary Wallace

REMARKS:

EXHIBIT 2

APPLICATION FOR BUSINESS/PROFESSIONAL ACCOUNT

12/15/7X
DATE

- Company
GOLIATH INDUSTRIES — 491-7326
Company Name — Telephone
276 MAIN ST. — CAMBRIDGE — MA 02138
Street (Address for billing purposes) — City — State/Zip

Check one:
Partnership ☐ Company ☐ ☒ Corporation under state laws of: DELAWARE
Year of founding or incorporation: 1961

- Bank – Please include complete address.
CAMBRIDGE TRUST CO., 1336 MASS. AVE., CAMBRIDGE MA 02138
Bank Name — Street — City — State/Zip

- Trade References (3). Please include complete address. Please do not use oil companies, credit cards, IBM, Xerox or public utilities, since these firms will not confirm such information.

1. TYPE SHOP
1435 STATLER BUILDING, BOSTON MA 02116
Street — City — State/Zip

2. PHANEUF PRESS
131 CLARENDON ST. BOSTON MA 02116
Street — City — State/Zip

3. BROOKS LABORATORIES
275 SUMMER ST. BOSTON MA 02116
Street — City — State/Zip

- Owners or Officers of your company
RICHARD G. MURPHY
President, Owner, Administrator
JOHN C. SULLIVAN
Treasurer
GAIL PERKINS
Accounts Payable (person to be contacted with regard to financial commitments)

- It is understood that all purchases made during a given month are payable in thirty (30) days or no later than the end of the following month. Accounts not paid in accordance with these terms will be charged a 1% monthly service charge which is equivalent to 12% annual interest.

Date 12/15/7X

Authorized signature and Company or Corporation Richard G. Murphy

---

- Authorization for bank credit inquiry

I hereby authorize the (name of bank) CAMBRIDGE TRUST to reveal normal credit information to our Credit Manager for the purpose of consideration of the establishment of trade credit.

Name of Account GOLIATH INDUSTRIES

Account Number 681-445-2

Authorized Signature Richard G. Murphy

EXHIBIT 2 (CONT.)

- If you need more than one invoice copy, please state requirements: NO
- Do you require purchase order numbers? ☐ Yes ☒ No
- Estimated monthly credit requirements $500
- Sales tax status
  - ☐ Taxable
  - ☒ Exempt/State number 02163857
    (If exempt, please include copy of your exemption certificate.)
  - ☐ Variable by purchase order
- Your Purchasing Procedures

  Name and title of person (if any) primarily responsible for purchasing.

  Name/Title JOHN ENGUSH, GRAPHICS DIR. Name/Title DENNIS LESSER, CHIEF ENG.

  Others who may place orders:

  Name/Title _____ Name/Title _____

Thank you for your time and effort in completing this application.